



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 730.5.40.1

January 11, 2005
05-PPD-005(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Revised Audit Guidance on Subcontract Assist Audits in Incurred Cost Audits

In accordance with the decision made at the June 2004 ESC meeting, revisions have been made to the audit guidance related to subcontract assist audits in incurred cost audits. The guidance in this memorandum is in effect until the subject revisions are incorporated into the CAM in the July 2005 update.

Background

The Mid-Atlantic Region submitted a proposal for revisions to the guidance on subcontract assist audits in incurred cost audits. The primary issues raised by the Mid-Atlantic Region were:

- Requests for assist audits should be made only once, not on an annual basis, and acknowledgements should be required of the subcontract auditor.
- Reporting for subcontract assist audits should only be the CACWS and the rate agreement letter, not a complete audit report.
- Results of subcontract assist audits will not impact the rates of the prime contractor's claim for that year; therefore, the prime report should not be qualified nor should subcontract costs be shown as unresolved.
- There was no useful purpose served by requiring the prime contract auditor to reconcile subcontract costs from the assist audits to the prime claimed costs on an annual basis.
- There was no benefit to issuing supplemental prime incurred cost reports for receipt of subcontract assist audits.
- Prime contractor responsibilities needed to be clarified.

A survey was distributed to the Regions to gather additional data, and after review of the data and some additional follow-up, Policy presented the results and the proposed revisions at the June 2004 ESC meeting. The ESC approved the following proposed changes to the guidance:

- Limit the annual requirement to reconcile the assist audit report results to prime contractor claimed costs to only those circumstances where there are large variances between the two (e.g., an amount greater than one month's worth of subcontract billings).

SUBJECT: Revised Audit Guidance on Subcontract Assist Audits in Incurred Cost Audits

- Revise the requirement to issue a supplemental prime incurred cost audit report upon receipt of the subcontract assist audit report to only those circumstances when it will serve a useful purpose.
- Require only an initial request for subcontractor assist audit, in lieu of an annual request, from the prime FAO, and re-emphasize the requirement for the assist FAO to send an acknowledgment letter.
- Clarify the prime contractor's responsibilities for obtaining subcontractor submissions and any required adjustment vouchers, and specify prime FAO required actions if those responsibilities are not performed.
- Modify the audit program to include a step to test for the subcontractor's timely submission of adjustment vouchers after settlement of the indirect rates.
- Clarify and enhance guidance for tracking and updating the CACWS for the status of subcontract assist audits.

Two other proposed changes by Mid-Atlantic Region were not accepted by the ESC. The first was that reporting the results of subcontract assist audits should only be done using the CACWS and the rate agreement letter, not a complete audit report. This was not adopted because generally accepted auditing standards require the issuance of a report when an audit has been performed. In addition, most subcontractors also perform as prime contractors, and therefore, would already be required to prepare a report. The second unadopted change was that the prime audit report should not be qualified, nor should subcontract costs be shown as unresolved, because the results of subcontract assist audits will not impact the rates. The qualification and identification of unresolved costs must be included in the report because direct costs (including subcontract costs) are subject to testing for allowability until final payment on the contract is made. Therefore, the costs will not be resolved until contract closeout, and must be identified as such in the prime contractor's annual incurred cost audit reports.

Guidance

As a result of the magnitude and complexity of incorporating the aforementioned approved guidance changes in the CAM, we believe that the revised process can best be explained through a flowchart. Enclosure 1 contains such a flowchart in the form of an FAO training presentation. The PowerPoint presentation illustrates and explains each step in the revised process, and culminates in a completed flowchart with accompanying notes that auditors and FAOs may use as a quick reference. It is recommended that this presentation be given to all auditors at the next scheduled FAO staff conference in FY 2005. Auditors currently involved in incurred cost audits where assist audits are required should individually go through the presentation, supplemented by reading the revised CAM guidance as necessary.

A summary of the substantive changes, by CAM section, is provided below. Draft documents attached to this memorandum show the detailed deleted and added CAM guidance language changes. Additional proposed changes are also shown to improve the clarity in the CAM sections impacted by the ESC approved changes.

SUBJECT: Revised Audit Guidance on Subcontract Assist Audits in Incurred Cost Audits

CAM 6-708 – Establishment of Final Indirect Cost Rates by Audit Determination

- 6-708.1e was re-written and moved under 6-708.4, Reporting Audit Results, to align the guidance for reporting audit results under the appropriate section.
- A new paragraph was added under 6-708.4 to clarify the circumstances under which it is appropriate to issue a qualified incurred cost audit report.

CAM 6-709 – Establishment of Final Indirect Cost Rates by Contracting Officer Determination

- 6-709.2b was renumbered and clarified for circumstances under which it is appropriate to issue a qualified report before completion of assist audits of corporate and/or subcontract costs.
- Language was added to clarify that the final audit action on the contract may be in the form of a Contract Audit Closing Statement or a CACWS.

CAM 6-711.3 – Cumulative Allowable Cost Worksheets

- Detailed guidance for updating the CACWS for the status of requests and receipt of reports for subcontract assist audits was added.
- Figure 6-7-3 was revised to incorporate a section for subcontract assist audit status and to add additional explanatory notes.

CAM 6-800 - Assist Audits of Incurred Costs

- Language was added to 6-801.1 to clarify the prime contractor's responsibilities for management of the subcontracts and moved to the new 6-802.2 to more appropriately align the subcontract guidance under section 6-802 "Subcontract Incurred Costs".
- Section 6-801.2, Special Considerations-Release of Subcontract Data to Higher Tier Contractor, was moved to 6-802.6 to more appropriately align the subcontract guidance under the 6-802 "Subcontract Incurred Costs" section.
- Language was added in the new section 6-802.3, Preparation of Subcontractors' Cost Submission, to address the fact that most subcontractors also perform as prime contractors and that the subcontract auditor should ensure that the subcontractor has an adequate billing system and submits timely adjustment vouchers.
- Guidance was revised in the new section 6-802.5, DCAA Audit of Subcontractors' Costs, to (i) eliminate annual requests for assist audit on the same subcontract, (ii) add the requirement for the subcontract auditor to submit final cumulative allowable costs to the prime contract auditor after subcontract completion, (iii) require the timely acknowledgment of assist audit requests, (iv) clarify that questioned costs from subcontract assist audits will be recovered through an adjustment voucher in the year the subcontractor's rates are settled, and (v) provide a new pro forma assist audit request as Figure 6-8-1.

SUBJECT: Revised Audit Guidance on Subcontract Assist Audits in Incurred Cost Audits

CAM 10-500 – Audit Reports on Annual Incurred Costs

- Language in 10-502c was deleted which stated that the audit report will generally not contain a qualified opinion or unresolved costs.
- Language was added to 10-504.4b "Qualifications" to be included in audit reports when assist audits of subcontracts have been requested.
- Language in 10-504.4c was deleted that discussed the reconciliation of subcontract costs to the prime contractor's claimed costs, on an annual basis, and issuance of a supplemental report upon receipt of subcontract assist audit reports since it is being replaced by the language in 10-504.4b.

Field audit office personnel should refer questions regarding this memorandum to their Regional offices. Regions unable to answer, or with questions of their own, should contact Patricia Letzler, Program Manager, Policy Programs Division, at (703) 767-2270.






/Signed/

Robert DiMucci
Assistant Director
Policy and Plans

Enclosures: 5

1. Subcontract CACWS Training Flowchart
2. Draft CAM 6-708&709
3. Draft CAM 6-711-3&Fig6-7-3
4. Draft CAM 6-801&802
5. Draft CAM 10-500

DISTRIBUTION: C

Enclosure 1	Enclosure 2	Enclosure 3	Enclosure 4	Enclosure 5
 Subcontract CACWS Training Flowchart.pdf	 Draft CAM 6-708&709.doc	 Draft CAM 6-711-3&Fig6-7-3.doc	 Draft CAM 6-801&802.doc	 Draft CAM 10-500.doc